Health Savings Accounts

In an effort to respond to the rising costs of health care, many employers are offering tax-favored accounts, such as health flexible spending accounts (health FSAs), health reimbursement arrangements (HRAs) and health savings accounts (HSAs).

What is a health savings account?
An HSA is a tax-exempt trust or custodial account established for the purpose of paying qualified medical expenses. An HSA accompanies a high deductible health plan (HDHP).

HSAs can be a powerful tax savings tool. In general, HSA contributions made by an eligible individual are tax-deductible, and employer HSA contributions made on behalf of an eligible employee are excluded from the employee's gross income. Interest and other earnings on HSA contributions accumulate tax-free. Amounts distributed from an HSA for qualified medical expenses are generally tax-free as well.

Keep in mind that some states define income differently than the IRS. As a result, HSAs that are tax-exempt at the federal level may not be tax-exempt at the state level.

Who can establish an HSA?
An individual may contribute to an HSA in any month in which he or she is covered under an HDHP on the first day of the month. The individual cannot be covered by another health plan that is not an HDHP (with certain exceptions), and he or she cannot be entitled to Medicare benefits or be claimed on another person's tax return. Self-employed individuals are eligible to establish an HSA.

What expenses are eligible for tax-free reimbursement from an HSA?
An HSA may reimburse qualified medical expenses incurred by the account beneficiary and his or her spouse and dependents. In addition to qualified medical expenses, COBRA premiums, health insurance premiums and qualified long-term care (QLTC) premiums may be reimbursed from an HSA. A full list of qualified medical expenses can be found here.

What expenses are not eligible for tax-free reimbursement from an HSA?
The following expenses may not be reimbursed from an HSA:

- Over-the-counter (OTC) drugs purchased without a prescription (except insulin);
- Premiums for Medicare supplemental policies;
- Expenses covered by another insurance plan;
- Expenses incurred prior to the date the HSA was established; or
- Any expenses other than qualified medical expenses and the HSA reimbursable premiums described above.

The amount withdrawn from an HSA for a non-qualifying medical expense is added to the account beneficiary's income and subject to a 20 percent penalty. If funds are distributed as a result of the account beneficiary's death, disability or after he or she becomes eligible for Medicare, the 20 percent penalty does not apply.

How much can an individual contribute to an HSA?
For each month an eligible individual is covered under an HDHP, he or she may contribute one-twelfth of $3,350 for individual coverage or one-twelfth of $6,750 for family coverage for calendar year 2016. For 2017, the annual HSA contribution limit increases to $3,400 for individual coverage and remains the same at $6,750 for family coverage. Individuals who are age 55 or older by the end of the tax year are permitted to make "catch-up contributions" and can contribute up to an additional $1,000 annually.

HSA contributions do **not** have to be made in equal amounts each month. An eligible individual can contribute in a lump sum or in any amounts or frequency he or she wishes.

Also, the HSA contribution limit is reduced by any contributions made to a medical savings account (MSA) in the same year. Rollover contributions from another HSA or MSA can be accepted. These rollover contributions are not subject to the annual contribution limit.

What are the differences between HSAs, HRAs, FSAs and MSAs?
The chart below provides a comparison among these tax-favored accounts.

Where can I find more information on HSAs?
To find more information about HSAs, visit:
www.irs.gov/publications/p969/ar02.html.

HSAs may not be right for all employers or individuals. Please contact Troy Shreve at Benefit Management, Inc. for assistance in determining what tax-advantaged account will best meet your goals.

This copy of Plan Designs is not intended to be exhaustive nor should any discussion or opinions be construed as legal advice. Readers should contact legal counsel for legal advice.

Comparison of Tax-advantaged Accounts

	HSA	MSA	HRA	FSA
Name of account	Health savings account	Medical savings account	Health reimbursement arrangement	Health flexible spending account
Who owns the account?	Individual/employee	Individual/employee	Employer	Employer
Who may fund the account?	Employer or employee, can be both in the same year Employee can contribute pre-tax dollars through Section 125 plan	Employer or employee, but **not** both in the same year Must be small employer or self-employed individual	Employer*	Employer/employee* Typically the employee contributes pre-tax dollars through a Section 125 plan
Does the uniform coverage rule apply?	No	No	No	Yes
Can unused funds be rolled over from year to year?	Yes	Yes	Yes	No, with two exceptions. If the FSA allows it, unused amounts may be used for expenses incurred during a grace period of 2½ months after end of plan year. Also, if the FSA does not incorporate a grace period, it may allow employees to carry over up to $500 in unused funds into the next plan year.
What expenses are eligible for reimbursement?	OTC drugs cannot be reimbursed unless they are prescribed or are insulin. -COBRA premiums -QLTC premiums -Health premiums while receiving unemployment benefits -If the owner of the account is Medicare-eligible due to age, health insurance premiums except medical supplement policies	OTC drugs cannot be reimbursed unless they are prescribed or are insulin. -COBRA premiums -QLTC premiums -Health premiums while receiving unemployment benefits	OTC drugs cannot be reimbursed unless they are prescribed or are insulin. Health insurance premiums for current employees, retirees, and qualified beneficiaries, and QLTC premiums Employer can define “eligible medical expenses”	OTC drugs cannot be reimbursed unless they are prescribed or are insulin. Expenses for insurance premiums are not reimbursable Employer can define “eligible medical expenses”

Comparison of Tax-advantaged Accounts

	HSA	MSA	HRA	FSA
Must claims submitted for reimbursement be substantiated?	No	Yes	Yes	Yes
May account reimburse non-medical expenses?	Yes, but taxed as income and 20 percent penalty (no penalty if distributed after death, disability, or age 65)	Yes, but taxed as income and 20 percent penalty (no penalty if distributed after age 65, death or disability)	No	No
Is interest earned on the tax-advantaged account?	Yes, accrues tax-free	Yes, accrues tax-free	Yes, paid to the employer	No

This chart is provided to you for informational purposes only. Please seek qualified and appropriate counsel for advice on how to apply the topics discussed herein to your employee benefits plan.